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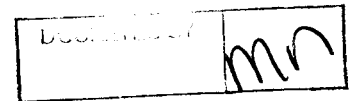
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ARIZONA, COLORADO, MONTANA,
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DISTRICT OF COLUMBIA

October 2, 2008

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED

OCT 2 2008



Re: Arizona Public Service Company
Docket No. E-01345A-08-0172
(Interim Rates)

To Whom It May Concern:

Enclosed for filing in the above-referenced proceeding are the original and thirteen (13) copies of a Closing Brief ("Closing Brief") on behalf of Mesquite Power, L.L.C., Southwestern Power Group II, L.L.C. and Bowie Power Station, L.L.C.

Also enclosed are two (2) additional copies of the Closing Brief. I would appreciate it if you would "filed" stamp the same and return them to me in the enclosed stamped and addressed envelope. Thank you in advance for your assistance. Please advise me if you have any questions.

Sincerely,

Angela R. Trujillo

Secretary

Lawrence V. Robertson, Jr.

DOCKET CONTROL
AZ CORP COMMISSION

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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF)
ARIZONA PUBLIC SERVICE COMPANY FOR) DOCKET NO. E-01345A-08-0172
A HEARING TO DETERMINE THE FAIR) (INTERIM RATES)
VALUE OF THE UTILITY PROPERTY OF THE)
COMPANY FOR RATEMAKING PURPOSES,)
TO FIX A JUST AND REASONABLE RATE OF) INTERVENOR MESQUITE
RETURN THEREON, TO APPROVE RATE) GROUP'S CLOSING BRIEF
SCHEDULES DESIGNED TO DEVELOP SUCH)
RETURN)

Pursuant to Chief Administrative Law Judge Farmer's directions at the conclusion of the evidentiary hearings on September 19, 2008 in the above-captioned and above-docketed proceeding, Mesquite Power, LLC, Southwestern Power Group II, LLC and Bowie Power Station, LLC (collectively "Mesquite Group") hereby submit their Closing Brief.

I.

STATEMENT OF MESQUITE GROUP'S POSITION ON APPLICANT'S REQUEST
FOR INTERIM RATE RELIEF

For the reasons discussed below in this Closing Brief, the Mesquite Group believes that (i) the Commission has the jurisdiction and authority to grant Arizona Public Service Company's ("APS") June 6, 2008 request for interim rate relief, and (ii) the Commission should issue an Opinion and Order granting APS interim rate relief in the amount of the \$115 million requested by APS, subject to the prospect of refund in whole or in part.

II.

THE COMMISSION HAS JURISDICTION AND AUTHORITY IN THE
CIRCUMSTANCES OF THE INSTANT PROCEEDING TO
GRANT THE REQUESTED INTERIM RATE RELIEF

1 **A. The Commission Inherently Possesses the Requisite Jurisdiction and Authority to**
2 **Grant Interim Rate Relief.**

3 The Commission has jurisdiction and authority in the circumstances of the instant
4 proceeding to grant the requested interim rate relief. That jurisdiction and authority was
5 confirmed in Arizona Attorney General Opinion No. 71-17, as issued on May 25, 1971
6 ("Opinion"). However, such jurisdiction and authority also exist independent of the Opinion.¹

7 More specifically, as noted in the Opinion,

8 "the Corporation Commission's rate-making functions are legislative in nature,
9 and the Commission in exercising such power of necessity possesses a broad
10 range of legislative discretion. Simms v. Round Valley Light & Power Co., 80
11 Ariz. 145, 294P.2d 378 (1965)." [Opinion at page 3]

12 In addition, as stated in the Opinion, (and also in Arizona Attorney General Opinion No. 71-15),

13 "...the Commission's broad and exclusive legislative power to choose the modes
14 by which it establishes rates

15 '...should be construed broadly enough to permit the
16 Commission to avail itself of concepts and procedures which are
17 devised from time to time to permit effective utility regulation and
18 to keep pace with constantly changing economic and social
19 conditions.'

20 "In our opinion the reasoning used and authorities cited in Opinion No. 71-15
21 apply with equal force to the authorization of interim rates by the Commission."
22 [Opinion at page 3]² [emphasis supplied]

23 **B. The Commission's Exercise of Its Interim Rate Making Jurisdiction and Authority**
24 **Is Not Confined to "Emergency" Situations.**

25 At least one (1) party to the instant proceeding has endeavored to suggest that APS'
26 request for interim rate relief should be denied, because APS has failed to demonstrate the
27 existence of a financial "emergency." Such assertion is not well-founded under Arizona law and
28

26 ¹ In that regard, opinions of the Attorney General are advisory in nature, and are not binding upon or restrictive of
27 the governmental entity requesting such opinion(s) and its exercise of such jurisdiction and authority as it may
28 otherwise possess. [Also, see Tr. 1068, l. 14-23]

26 ² As also noted at page 5 of the Opinion, "The statutes pertaining to the Commission's powers over rates and
27 charges are written broadly enough to permit the Commission to choose the manner of giving effect to the powers
28 granted. See A.R.S. §§ 40-203, -250, -251, -365, and -367."

1 the statutes which pertain to the Commission's exercise of its rate-making jurisdiction and
2 authority. In addition, such assertion also is not well-founded when examined within the context
3 of the Opinion.

4 More specifically, in discussing whether or not a ratepayer has a right to notice and
5 opportunity to be heard with regard to a request for interim rate relief, the Opinion states that
6 such right does not exist

7 "...if the Commission limits the granting of interim rates to situations of
8 true emergency." [Opinion at page 7]

9 However, the Opinion also indicates that interim rate relief may be "granted in non-emergency
10 situations," provided that ratepayers are provided the aforesaid notice and an opportunity to be
11 heard. [Opinion at page 8] Clearly, such notice and opportunity to be heard have been provided
12 in the circumstances of the instant proceeding, as evidenced by the intervention and active
13 participation of both the Commission's Staff and RUCO on behalf of APS' ratepayers.
14 Accordingly, the demonstration of a financial "emergency" is not a legal prerequisite to the
15 jurisdiction and authority of the Commission to grant APS interim rate relief in the instant
16 proceeding.

17 **C. The Commission Need Not Make a Determination of "Fair Value" Prior to**
18 **Establishing Interim Rates.**

19 At least one (1) party to the instant proceeding also appears to have intimated that APS'
20 request for a \$115 million in interim rate relief cannot be granted, in the absence of a prior
21 Commission determination of plant investment and adjusted test period expenses sufficient to
22 support a rate increase in that amount. As indicated in the discussion appearing at pages 9 and
23 10 of the Opinion, such intimation is without a foundation in either law or fact and should thus
24 be disregarded. More specifically, the Opinion expressly states that

25 "...the Corporation Commission need not establish the fair value of the property
26 of a public service corporation prior to establishing interim rates" [Opinion at
page 9];

27 and, the Opinion finds
28

1 "...no legal requirement that a 'temporary fair value' be established prior to the
2 establishment of interim rates." [Opinion at page 10]

3 **D. The Commission Has Previously Granted Interim Rate Relief Under Circumstances**
4 **Which Did Not Constitute an "Emergency."**

5 The Commission has previously granted interim rate relief to APS under circumstances
6 which did not constitute an "emergency." Examples include Decision No. 48569, which was
7 issued on January 4, 1978, and Decision No. 55228, which was issued on October 9, 1986.
8 Moreover, on several other occasions the Commission has granted interim rate relief to APS
9 without finding an "emergency" of the types discussed in the Opinion. [See Tr. 799, l. 3-9]
10 Thus, not only is there legal jurisdiction and authority for the Commission to grant interim rate
11 relief, as requested by APS in the instant proceeding, there is also ample precedent.

12 **E. Summary**

13 For the reasons discussed above, it is abundantly clear that the Commission has
14 jurisdiction and authority in the circumstances of the instant proceeding to grant the requested
15 interim rate relief.

16 **III.**

17 **THE COMMISSION SHOULD ISSUE AN OPINION AN ORDER**
18 **GRANTING APS INTERIM RATE RELIEF IN THE AMOUNT OF**
19 **\$115 MILLION REQUESTED BY APS**

20 **A. In Determining Whether or Not to Grant Interim Rate Relief, the Commission**
21 **Should Accord Great Weight to That Which is Necessary to Protect the Long-Term**
22 **Interests of APS' Ratepayers.**

23 The evidentiary record in this instant proceeding consists of 1,092 transcript pages,
24 dozens of exhibits and numerous opinions as to what the credit rating agencies might or might
25 not do in the foreseeable future with regard to APS' credit ratings. More specifically, the
26 conjecture centers upon whether APS' securities will be downgraded to "junk" status, in the
27 event that the Commission either denies APS' currently pending request for interim rate relief, or
28 grants APS what is perceived to be an inadequate amount. In reality, neither the Commission

1 nor the parties to the instant proceeding know the answer to that question; and, they will not
2 know the answer prior to the Commission's issuance of its decision on APS' interim rate relief
3 request. Hence, the next question becomes one of how the Commission should proceed in the
4 face of such uncertainty.

5 APS witness Charles Ciccetti has suggested that central to the Commission's decision-
6 making process should be a determination of that course of action which is in the best long-term
7 interest of APS' ratepayers. In that regard, the following excerpts from his testimony provide a
8 meaningful context within which to examine that question.

9 "So the very thing that I think the market is concerned about now, which is
10 protecting principal, getting your investment back, raises the problem that is
11 sometimes called the attrition problem here or the regulatory lag problem here.
12 But it's essentially a loss of recovery of investment.

13 "That's what really this case is about, and I think you'll hear more about it in the
14 final rate case, that recovery of investments is now the primary concern in the
15 capital markets and the financial markets, and that's what is causing people to
16 have so much angst.

17 "Add to that the fact that what you have is the credit rating agencies being in a
18 sense accused of not doing their job by predicting things soon enough so that
19 investors might have either avoided investment or gotten their capital out and
20 protecting their principal. These credit rating agencies, I think, are going to be on
21 a very sort of hair pull trigger that will make them more likely than they were a
22 week ago to put out the news of a downgrade or a threat sooner rather than later.

23 "And those two things together, which is how I'm viewing the events of the last
24 couple of weeks...those two events over the past week are the kind of things that
25 make it, in my mind, a certainty that without some positive news coming out of
26 this interim case, that APS will, in fact, be downgraded." [Tr. 822, l. 16-Tr. 823,
27 l. 17]

28 * * *

29 "...They've actually done something extraordinary by telling [APS Chief
30 Executive Officer and President] Mr. Brandt that they were about ready to do it.
31 That's pretty unprecedented in my experience. That's not usual." [Tr. 824, l. 10-
32 13]

* * *

1 “They [potential future lenders to APS] need some kind of signal, some kind of
2 assurance that they will get their capital back. And if they don’t get that
3 assurance, they may still lend the money, but it will be at a much higher interest
4 rate, and consumers will pay for that.³

5 “And the burden, ultimately, then comes back to why I refer to the consumer
6 crisis. Because Arizona Public Service will do whatever it has to do, pay
7 whatever it has to pay, to get the job done, but the consumers will pay a lot more
8 than they otherwise would have paid, and that’s why I call it the consumer crisis
9 or a consumer emergency.” [Tr. 845, l. 9-20] [emphasis added]

10 Simply stated, Mr. Ciccetti is recommending that, incident to reaching a decision on
11 APS’ request for immediate approval and implementation of an interim rate increase, the
12 Commission should carefully consider and accord great weight to protection of the long-term
13 interests of APS’ ratepayers. In the circumstances of this proceeding, the Mesquite Group
14 concurs with that recommendation.

15 **B. A Commission Decision Granting APS an Interim Rate Increase In the Amount of**
16 **\$115 Million Would Be Conducive to Protection of the Long-Term Interests of APS’**
17 **Ratepayers.**

18 There appears to be no disagreement among the parties that a downgrading of APS’
19 credit rating to “junk” status would be to the substantial detriment of APS and its ratepayers, in
20 the form(s) of (i) reduced access to and increased cost of capital, (ii) reduced operating flexibility
21 in dealing with suppliers and vendors, and (iii) a prolonged passage of time before an investment
22 grade quality credit rating status could be regained, if ever.⁴ Rather, the disagreement(s) in the
23 instant proceeding have revolved around (i) the likelihood of a credit rating downgrade to “junk”
24 in the absence of a decision granting interim rate relief, and (ii) the amount of interim rate relief
25 necessary to avoid such a development.

26 As previously noted, the evidentiary record in the instant proceeding does not provide a
27 precise answer or a finely-tuned measure of the probability of a credit rating downgrade to
28

³ Similarly, merchant generators and other suppliers and vendors might still be willing to do business with APS, but their credit terms and requirements will be more exacting, with the resulting increased costs and restricted operating flexibility ultimately borne by APS’ ratepayers.

⁴ See, for example, the testimony of ACC Staff witness David Parcell on the desirability of APS retaining an investment grade rating [Tr. 979, l. 17-23]; and, the testimony of RUCO witness Stephen Ahearn as to why the existence of a meaningful risk of downgrading to “junk” should be avoided. [Tr. 1072, l. 20-Tr. 1074, l. 6]

1 “junk” for APS, in the absence of a decision granting adequate interim rate relief at this time.
2 That is a decision that the Commission is ultimately going to have to reach, relying upon the
3 collective judgment of its members, and with a view towards protection of the long-term
4 interests of APS’ ratepayers. However, the record does contain evidence as to what might be an
5 appropriate level of interim rate relief, if the Commission’s regulatory objective is to reduce the
6 risk of downgrading to a “reasonable” level.

7 More specifically, APS Chairman William Post testified that

8 “To me, the objective is not 18 percent or 18.25 percent [for a FFO/Debt ratio].
9 The objective is to reasonably reduce the risk to our customers of the potential
10 negative consequences of a downgrade.” [Tr. 723, l. 18-21] [emphasis added]

11 Mr. Post was then asked what level of interim rate relief in his opinion would achieve that
12 reasonable reduction of risk, and he responded as follows:

13 “Q. Okay, let me ask you, in light of the financial and economic developments
14 which have occurred since the company filed its interim rate request in June of
15 this year, do you share Mr. Brandt’s opinion that an interim rate increase of \$115
16 million would be sufficient to reasonably reduce the risk of downgrade?

17 “A. I do, but I would like to add one other thing to that... there is really two parts
18 to this.

19 “The first part is the actual granting of the interim request. The second one is
20 recognition in a positive manner that this Commission is going to work with APS
21 going forward to deal with the challenges that we face, not to look backwards.
22 We cannot deal as a company, and I don’t believe we can deal with the energy
23 challenge of our state, by looking backwards. I understand we have the historical
24 test year, and I’m not suggesting we change that. We don’t need to change that.
25 What we need to do is supplement that.” [Tr. 724, l. 19-Tr. 725, l. 20] [emphasis
26 added]

27 In addition, there is other evidence in the record which supports the granting of \$115
28 million in interim rate relief as a means for reasonably reducing the risk of a credit rating
downgrade to “junk.” Exhibit APS-6 indicates that (i) at APS’ current rates and (ii) without a
\$400 million common equity issue in 2008 or 209, APS’ FFO/Debt ratio would be 16.4%.⁵ That

⁵ In that regard, APS witness Brandt testified that APS’ current and perceived financial circumstances will not allow it to proceed with the previously authorized \$400 million common equity issue during 2008 or 2009; and, significantly, during the hearings the Commission’s Staff withdrew its pre-hearing requirement that any grant of interim rate relief be contingent upon APS issuing \$400 million of common equity.

1 ratio would be improved somewhat if the projected capital expenditures reductions of \$500
2 million-plus currently under consideration by APS are taken into account.⁶ But, in all likelihood,
3 such increase in APS' 2009 year-end FFO/Debt ratio would not exceed that 18% "minimum"
4 required for Business Profile 6 companies, such as APS.

5 Similarly, Exhibit APS-9 depicts that an interim rate increase of \$166.4 million would be
6 required to achieve that FFO/Debt ratio "target" suggested by AECC witness Kevin Higgins,
7 when adjusted to eliminate a \$400 million common equity issuance during 2008 or 2009.
8 However, Exhibit APS-21 indicates that the FFO/Debt ratio is reduced to 17.6% at year-end
9 2009, if the calculation assumes APS' requested interim rate relief of \$115 million, rather than
10 the \$166.4 million level derived within the context of Exhibit APS-9.

11 As previously noted, no one is in a position to conclude at this juncture that a
12 Commission decision granting APS \$115 million in interim rate relief would in fact preclude the
13 risk of a subsequent credit rating downgrade to "junk." However, APS' Chairman and APS'
14 President and Chief Executive Officer have testified as to their belief that interim rate relief in
15 the amount of \$115 million would substantially contribute towards a reasonable reduction in the
16 risk of such a downgrading at this time. Moreover, the FFO/Debt ratios indicated by Exhibit
17 APS-6 and Exhibit APS-21, when combined with the \$500 million-plus of capital expenditure
18 reductions contemplated by Exhibit APS-8, would suggest the existence of a near-term credit
19 metric which should enable APS to avoid a downgrading to "junk" in the near-term future.

20 In that regard, and with reference to the second (or "going forward") conceptual predicate
21 underlying APS witness Post's previously-quoted opinion as to how the risk of downgrading
22 may be reasonably reduced, it should be recognized that there is nothing the Commission can do
23 to address that aspect at this time. That is because three (3) of the current members of the
24 Commission will be leaving office before APS' request for a permanent rate increase proceeds to
25 hearing, and a decision in that proceeding in all likelihood will not be issued before the third
26 quarter of 2009 at the earliest. However, the Commission is in a position to address at this time

27
28 ⁶ Exhibit APS-8 depicts, by general plant categories, the magnitude of capital expenditure reductions currently under consideration by APS for the 2009-2011 period.

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1 within the context of the current interim rate proceeding the first (or "interim rate relief")
2 conceptual predicate underlying Mr. Post's opinion. In so doing, and by promptly granting APS
3 an interim rate increase of \$115 million, the Commission could (i) act to reasonably reduce the
4 risk of APS being downgraded to "junk," and thereby (ii) act with the objective of facilitating the
5 protection of the long-term interests of APS' ratepayers.

6 **C. By Granting Interim Rate Relief, Which is Subject to the Prospect of Refund, the**
7 **Commission Can Also Protect the Short-Term Interests of APS' Ratepayers.**

8 As of this juncture, neither the Commission nor the parties know whether APS will be
9 able to demonstrate in the 2009 hearings on its request for permanent rate relief that it is entitled
10 to an increase of at least \$115 million. Accordingly, it would be appropriate for the Commission
11 to condition a grant of interim rate relief in that amount upon the prospect that all or a portion of
12 the same is subject to refund, with interest, in the event that APS is unable to demonstrate in the
13 forthcoming permanent rate proceeding that it is lawfully entitled to a permanent increase in
14 rates of at least that amount. By so doing, the Commission could address and protect the short-
15 term interests of APS' ratepayers, which the current members of the Commission are in a
16 position to do.

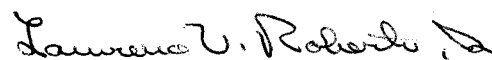
17 **IV.**

18 **CONCLUSION**

19 For all of the reasons discussed above, the Mesquite Group believes that (i) the
20 Commission has the jurisdiction and authority to grant APS' June 6, 2008 request for interim rate
21 relief, and (ii) the Commission should issue an Opinion and Order granting APS interim rate
22 relief in the amount of the \$115 million requested by APS, subject to the prospect of refund in
23 whole or in part.

24 Dated this 1st day of October 2008.

25
26 Respectfully submitted,

27 

28 Lawrence V. Robertson, Jr.

Attorney for Mesquite Power Company, L.L.C.,
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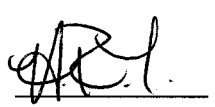
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